How to Re-Title Your Inherited IRA Account

What's the best way to title an IRA when you inherit it?

I'm personally involved with two different inherited IRAs, both maintained by the same bank. That bank has transferred the IRAs of the people who died to the beneficiaries using inherited accounts. And the bank insists on titling those accounts as follows: "Mary Smith Bene Susan Smith."

My research indicates that the best, and possibly the only proper, way to title an inherited account would be as follows: "Mary Smith (deceased 1/30/06) Inherited IRA for benefit of Susan Smith, Beneficiary." But the bank has said it will not accept my titling and insists that its method is sufficient under the Internal Revenue Code to enable the beneficiaries to receive required minimum distributions based on their life expectancies.

Is there any income-tax risk if the accounts are not titled as I have requested, and instead are titled as the bank has done?

Milton Wollman
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THE ACCOUNTS should be in good shape—although the bank's wording could be a bit clearer. (We assume "Bene" is shorthand for "Beneficiary.") That said, you're right to handle inherited IRAs with extra care to make sure they are set up correctly.

It's easy to deal with an IRA you inherit from your husband or your wife, because you can simply roll it into your own individual retirement account. But if you inherit an IRA from anyone else, there are some key rules to follow upfront to squeeze the most value out of your inheritance. (Those rules are spelled out in the Internal Revenue Service's Publication 590, available at www.irs.gov/pub/irs-pdf/p590.pdf.)

If you inherit a traditional IRA from anyone other than your spouse, you can't treat it as your own. Instead, you need to have the account re-titled. According to IRS Notice 2007-7, the IRA must be "established in a manner that identifies it as an IRA with respect to a deceased individual and also identifies the deceased individual and the beneficiary, for example, 'Tom Smith as beneficiary of John Smith.' "

In other words, make sure to include the name of the deceased IRA owner in the title, along with an indication that it's for the benefit of the person who inherited it, says Ed Slott, an IRA consultant in Rockville Centre, N.Y. "There's no set form. As long as the deceased's name is there and it's clear that it's an inherited account, not the beneficiary's own IRA, it's OK."

Mr. Slott generally recommends this language: "John Smith, IRA (deceased on May 21, 2007) F/B/O John Smith Jr., beneficiary." (F/B/O stands for "for the benefit of.")

Why go to all this trouble, readers may wonder? As Mr. Wollman references, the beneficiary of an inherited IRA can stretch out withdrawals from the account across his or her life expectancy. That means the assets have the potential to continue to grow, with earnings continuing to accrue on a tax-deferred basis. If an IRA has more than one heir, those heirs may be able to split the inherited account so they can use their individual life expectancies to take withdrawals. To do so, they have to separate the account by the end of the year following the year of the original owner's death. Otherwise, they have to use the oldest heir's age to calculate everyone's withdrawals. (The specific distribution rules and life-expectancy table involved are also in IRS Publication 590.)

What if you inherit a Roth IRA? You still have to go through the re-titling process and take distributions on a schedule—but you generally won't owe any tax.

If you don't title the account properly as an inherited IRA, or you put the assets in your own IRA, you trigger immediate taxation on the account's entire value. And it's a mistake that cannot be corrected, Mr. Slott says.

One other thing to keep in mind: After you re-title an inherited IRA, name a beneficiary of your own, known as a "successor beneficiary," if the IRA's custodian will let you do so.

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